

ST 98-33

Tax Type: SALES TAX

Issue: Audit Methodologies and/or Other Computational Issues

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
SPRINGFIELD, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE
d/b/a DOE'S BUSINESS
Taxpayer**

**Docket No.
IBT #
NTL #**

RECOMMENDATION FOR DISPOSITION

Appearances: Charles Hickman, Special Assistant Attorney General, for the Department of Revenue of the State of Illinois; Michael W. Atkins, Attorney at Law, for JOHN DOE d/b/a DOE'S BUSINESS.

Synopsis:

The Department of Revenue ("Department") conducted an audit of the business known as DOE'S BUSINESS, which is operated by JOHN DOE ("taxpayer"). At the conclusion of the audit, the Department issued a Notice of Tax Liability (NTL) to the taxpayer; he timely protested the NTL. An evidentiary hearing was held during which the taxpayer raised the following issues: (1) whether the Department's method for determining the audit liability was reasonable; (2) whether the taxpayer presented sufficient documentary evidence to show he does not owe the liability. After reviewing the record, it is recommended that this matter be resolved in favor of the Department.

FINDINGS OF FACT:

1. The taxpayer is the owner and operator of a business known as DOE'S BUSINESS located in FICTITIOUS CITY, Illinois. (Tr. p. 55)

2. The Department audited the taxpayer's business for the period of January 1, 1994 to June 30, 1996. (Dept. Group Ex. #1)

3. On December 13, 1996, the Department's auditor hand-delivered a "Notice of Demand for Documentary Evidence" to the taxpayer. The Notice required the taxpayer to produce documentation within 60 days of the issuance of the Notice. The taxpayer did not produce the documents within that time period. (Dept. Group Ex. #1; Tr. pp. 11-13)

4. Because the taxpayer did not provide records for the business, the auditor estimated the tax liability for the audit period. To do this, the auditor used the taxpayer's 1993 food and drink costs as determined by a previous audit. The auditor marked this up by 63.7%, which the auditor stated was the national average markup for taverns, in order to determine the estimated gross receipts for the audit period. (Dept. Ex. #2; Taxpayer Ex. #4; Tr. pp. 11-12, 20-24)

5. The auditor subtracted the gross receipts actually reported by the taxpayer from the estimated gross receipts. He calculated the tax on this amount to determine the liability. (Dept. Ex. #2; Taxpayer Ex. #4; Tr. pp. 11-12, 20-24)

6. The taxpayer did not present any documents or records, such as cash register tapes or daily sales records, that indicate what the actual gross receipts were during the audit period.

7. On August 18, 1997, the Department prepared a corrected return for the audit period. The return shows that the taxpayer owes tax in the amount of \$36,318, a late payment penalty of \$5,448, and a negligence penalty of \$7,264. The corrected return was admitted into evidence under the certification of the Director of the Department. (Dept. Group Ex. #1)

CONCLUSIONS OF LAW:

The Retailers' Occupation Tax Act ("ROTA") (35 ILCS 120/1 *et seq.*) imposes a tax upon persons engaged in the business of selling at retail tangible personal property. 35 ILCS 120/2. Sections 4 and 5 of the ROTA provide that the certified copy of the corrected return issued by the Department "shall be prima facie proof of the correctness of the amount of tax due, as shown therein." 35 ILCS 120/4, 5. Once the Department has established its *prima facie* case by submitting the corrected return into evidence, the burden shifts to the taxpayer to overcome this presumption of validity. A.R. Barnes & Co. v. Department of Revenue, 173 Ill.App.3d 826, 832 (1st Dist. 1988). To prove its case, a taxpayer must present more than its testimony denying the accuracy of the Department's assessment. Mel-Park Drugs, Inc. v. Department of Revenue, 218 Ill.App.3d 203, 217 (1st Dist. 1991). The taxpayer must present sufficient documentary evidence to support its claim. Id.

Under the ROTA, the Department is required to correct the tax return according to its "best judgment and information." 35 ILCS 120/4. There is no requirement that the Department substantiate the basis for its corrected return at the hearing. Masini v. Department of Revenue, 60 Ill.App.3d 11, 14 (1st Dist. 1978). When the corrected return is challenged, however, the method that was used by the Department in correcting the

return must meet a minimal standard of reasonableness. Id.; Elkay Manufacturing Co. v. Sweet, 202 Ill.App.3d 466, 470 (1st Dist. 1990).

In this case, the Department's method of preparing the return was reasonable. The taxpayer did not have a system for controlling the cash receipts, and he did not give the auditor documents that accurately reflected gross receipts. (Tr. pp. 24-5) The bank statements did not accurately show the gross receipts of the business because they did not necessarily include all of the income. The taxpayer did not provide the auditor with documents such as cash register tapes or daily sales records that correspond to the deposits on the bank statements. (Tr. pp. 25, 27)

Because the auditor did not have documents from which to determine the tax, he estimated the liability. He used the taxpayer's food and drink costs from 1993 as a basis for the estimate. The cost figures were obtained during a previous audit by contacting the taxpayer's vendors. (Tr. pp. 25-6) The 1993 figures were marked up 63.7%, which the auditor stated was the national average for taverns. Although the taxpayer claims that a lower percentage should have been used, he did not provide any documentation justifying a smaller percentage. The taxpayer's accountant stated that the IRS determined that the taxpayer's income for the same time period was less than the Department's determination, but the accountant did not have any documents reflecting the IRS determination. (Tr. p. 48) The accountant also admitted that the income determination reached by the IRS was only "slightly different" from the Department's conclusion. (Tr. p. 49) After subtracting the amount of gross receipts previously reported by the taxpayer from the estimated gross receipts, the Department's auditor determined the tax liability. The Department correctly states that this method was reasonable given the fact that the

taxpayer failed to maintain adequate records. (See Vitale v. Department of Revenue, 118 Ill.App.3d 210 (3rd Dist. 1983)).

The taxpayer did not present sufficient documentary evidence showing the Department's determination should be reduced. Although the taxpayer provided an income statement for 1995, he did not provide documents supporting the figures on the statement. (Tr. pp. 26-7) The accountant admitted that he did not independently verify the figures on the income statement. (Tr. pp. 46-7) The taxpayer did not know the location of the cash register receipts and did not provide them at the hearing. (Tr. pp. 49-50, 58) Other than the income statement, the only evidence presented was testimony from the taxpayer and his accountant. Unsubstantiated testimony is insufficient to overcome the Department's *prima facie* case. (Mel-Park Drugs, Inc. at 217.) The taxpayer has therefore failed to meet its burden of proof.

Recommendation:

For the foregoing reasons, it is recommended that the Notice of Tax Liability be upheld.

Linda Olivero
Administrative Law Judge